

court proceeding (except in case of jeopardy), of the deficiency and all interest, additional amounts, and assessable penalties, shall be stayed for a period of 120 days after the date of such determination, and, to the extent any part of such deficiency remains after deduction for deficiency dividends, for an additional period until the date the claim is disallowed. After such claim is allowed or rejected, either in whole or in part, the amount of the deficiency which was not eliminated by the application of section 547, together with interest, additional amounts and assessable penalties, will be assessed and collected in the usual manner.

§ 1.547-7 Effective date.

The deduction for deficiency dividends, in computing personal holding company tax for any taxable year, is allowable only with respect to determinations under section 547(c) made after November 14, 1954 (the date falling 90 days after the date of enactment of the Internal Revenue Code of 1954). If the taxable year with respect to which the deficiency is asserted began before January 1, 1954, the deficiency dividends deduction shall include only the amounts which would have been includible in the computation of the basic surtax credit for such taxable year under the Internal Revenue Code of 1939. Section 547(g), relating to the denial of a deficiency dividends deduction if the determination contains a finding that any part of the deficiency is due to fraud, etc., shall apply only if the taxable year with respect to which the deficiency is asserted begins after December 31, 1953.

FOREIGN PERSONAL HOLDING COMPANIES

§ 1.551-1 General rule.

Part III (section 551 and following), subchapter G, chapter 1 of the Code, does not impose a tax on foreign personal holding companies. The undistributed foreign personal holding company income of such companies, however, must be included in the manner and to the extent set forth in section 551, in the gross income of their *United States shareholders*, that is, the shareholders who are individual citizens or residents of the United States, domes-

tic corporations, domestic partnerships, and estates or trusts other than estates or trusts the gross income of which under subtitle A of the Code includes only income from sources within the United States.

§ 1.551-2 Amount included in gross income.

(a) The undistributed foreign personal holding company income is included only in the gross income of the United States shareholders who were shareholders in the company on the last day of its taxable year on which a United States group (as defined in section 552(a)(2)) existed with respect to the company. Such United States shareholders, accordingly, are determined by the stock holdings as of such specified time. This rule applies to every United States shareholder who was a shareholder in the company at the specified time regardless of whether the United States shareholder is included within the United States group. For example, a domestic corporation which is a United States shareholder at the specified time must return its distributive share in the undistributed foreign personal holding company income even though the domestic corporation cannot be included within the United States group since, under section 554, the stock it owns in the foreign corporation is considered as being owned proportionately by its shareholders for the purpose of determining whether the foreign corporation is a foreign personal holding company.

(b) The United States shareholders must include in their gross income their distributive shares of that proportion of the undistributed foreign personal holding company income for the taxable year of the company which is equal in ratio to that which the portion of the taxable year up to and including the last day on which the United States group with respect to the company existed bears to the entire taxable year. Thus, if the last day in the taxable year on which the required United States group existed was also the end of the taxable year, the portion of the taxable year up to and including such last day would be equal to 100 percent and, in such case, the United States shareholders would be required

to return their distributive shares in the entire undistributed foreign personal holding company income. But if the last day on which the required United States group existed was September 30, and the taxable year was a calendar year, the portion of the taxable year up to and including such last day would be equal to nine-twelfths and, in that case, the United States shareholders would be required to return their distributive shares in only nine-twelfths of the undistributed foreign personal holding company income.

(c) The amount which each United States shareholder must return is that amount which he would have received as a dividend if the above-specified portion of the undistributed foreign personal holding company income had in fact been distributed by the foreign personal holding company as a dividend on the last day of its taxable year on which the required United States group existed. Such amount is determined, therefore, by the interest of the United States shareholder in the foreign personal holding company, that is, by the number of shares of stock owned by the United States shareholder and the relative rights of his class of stock, if there are several classes of stock outstanding. Thus, if a foreign personal holding company has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any distribution may be made to the common shareholders, then the assumed distribution of the stated portion of the undistributed foreign personal holding company income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

(d) The assumed distribution of the required portion of the undistributed foreign personal holding company income must be returned as dividend income by the United States shareholders for their respective taxable years in which or with which the taxable year of the foreign personal holding company ends. For example, if the M Corporation, whose taxable year is the calendar year, is a foreign personal holding company for 1954 and if A, one of its United States shareholders, makes

returns on a calendar year basis, while B, another United States shareholder, makes returns on the basis of a fiscal year ending November 30, A must return his assumed dividend as income for the taxable year 1954 and B must return his distributive share as income for the fiscal year ending November 30, 1955. In applying this rule, the date as of which the United States group last existed with respect to the company is immaterial. Thus, in the foregoing example, if September 30, 1954, was the last day on which the United States group with respect to the M Corporation existed, B would still be required to return his assumed dividend as income for the fiscal year ending November 30, 1955, even though September 30, 1954, the date as of which the distribution is assumed to have been made, does not fall within such fiscal year.

(e) For the treatment of gain on the sale of certain stock, see section 306(f) and paragraph (h) of § 1.306-3.

§ 1.551-3 Deduction for obligations of the United States and its instrumentalities.

(a) Each United States shareholder required to return his distributive share of undistributed foreign personal holding company income for any taxable year shall take into account in computing the credit against tax under section 35, or the deduction under section 242, whichever is allowable to such shareholder, his proportionate share of whatever interest on obligations of the United States or its instrumentalities (as specified in sections 35 or 242, as the case may be) may be included in the gross income of the company for such taxable year, with the exception of any such interest as may be so included by reason of the application of the provisions of section 555. For reduction of credit for such interest on account of amortizable bond premium, see section 171 and the regulations thereunder.

(b) The rule set forth in paragraph (a) of this section may be illustrated by the following example:

Example. The M Corporation is a foreign personal holding company which owns all the stock of the N Corporation, another foreign personal holding company. Both companies receive interest on obligations of the United States or its instrumentalities as specified in section 35. In determining the

amount of the credit allowable under section 35 (if the shareholder is an individual) or the deduction allowable under section 242 (if the shareholder is a corporation), the United States shareholder of the M Corporation would be entitled to a credit or a deduction, as the case may be, only for his proportionate share of the interest received by that Company and not for any part of the interest received by the N Corporation, regardless of whether the interest received by the N Corporation is included in the gross income of the M Corporation as an actual dividend or as a constructive dividend under section 555.

§ 1.551-4 Information in return.

The information required by section 551(d) in the returns of certain United States shareholders relates only to the taxable year of a foreign personal holding company for which any part of such corporation's undistributed foreign personal holding company income must be included in gross income by the United States shareholder of whom the information is required. The information shall be submitted as a part of the income tax return in the form of a statement attached to the return.

§ 1.551-5 Effect on capital account of foreign personal holding company and basis of stock in hands of shareholders.

(a) Sections 551(e) and 551(f) are designed to prevent double taxation with respect to the undistributed foreign personal holding company income.

(b) The application of sections 551(e) and 551(f) may be illustrated by the following examples:

Example 1. The M Corporation is a foreign personal holding company. Seventy-five percent in value of its capital stock is owned by A, a citizen of the United States, and the remainder, or 25 percent, of its stock is owned by B, a nonresident alien individual. For the calendar year 1954 the M Corporation has an undistributed foreign personal holding company income of \$100,000. A is required to include \$75,000 of such income in gross income as a dividend in his return for the calendar year 1954. The \$100,000 is treated as paid-in surplus or as a contribution to the capital of the M Corporation and its accumulated earnings and profits as of the close of the calendar year 1954 are correspondingly reduced. If after treating such \$100,000 as paid-in surplus or as a contribution to capital, the M Corporation has no accumulated earnings and profits at the close of 1954, and if for the calendar year 1955, the M Corporation had no earnings and profits, but distributed \$40,000,

the amount so distributed would be a non-taxable distribution and would not be included in the gross income of either A or B for the calendar year 1955. If, however, after treating the \$100,000 as paid-in surplus or as a contribution to capital, the M Corporation had accumulated earnings and profits of \$100,000 at the close of 1954, the facts otherwise being the same, the distributions in 1955 would be taxable to A as a dividend, and the taxability of such distributions to B would depend upon the application of section 861(a)(2), relating to the treatment of dividends from a foreign corporation as income from sources within or without the United States.

Example 2. In example 1 assume the basis of A's stock to be \$300,000. If A includes in gross income in his return for the calendar year 1954, \$75,000 as a dividend from the M Corporation, the basis of his stock would be \$375,000. After the nontaxable distribution of \$30,000 to A by the M Corporation in 1955 (75 percent of the \$40,000 distribution) the basis of A's stock, assuming no other changes, would be \$345,000. If A failed to include the \$75,000 as a dividend in gross income in his return for 1954 and his failure was not discovered until after the 6-year period of limitations had expired, the application of the rule would not increase the basis of A's stock. The subsequent nontaxable distribution of \$30,000 to A in 1955 would reduce his basis of \$300,000 to \$270,000, thus tending to compensate for his failure to include the amount of \$75,000 as a dividend in his gross income for 1954. If the undistributed foreign personal holding company income of the M Corporation is readjusted within the statutory period of limitations, thus increasing or decreasing the amount A would have to include in his gross income, proper adjustment is required to be made to the basis of A's stock on account of such readjustment.

§ 1.552-1 Definition of foreign personal holding company.

(a) A foreign personal holding company is any foreign corporation, other than a corporation exempt from taxation under subchapter F (section 501 and following), chapter 1 of the Code, and other than certain banking institutions which satisfy the requirements of section 552(b)(2) and paragraph (b) of § 1.552-4 which for the taxable year meets (1) the gross income requirement specified in section 552(a)(1); and (2) the stock ownership requirement specified in section 552(a)(2). Both requirements must be satisfied with respect to each taxable year.

(b) A foreign corporation which comes within the classification of a